

**Final Order Denying Refund: 04-20191059R
Gross Retail and Use Tax
For the Year 2015, 2016, and 2017**

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

Insurance Company was not entitled to a refund of use tax paid on the purchase of prewritten computer software purchased from various vendors and utilized in part by Insurance Company's Indiana employees; Insurance Company was not entitled to a refund of tax paid on the purchase of software maintenance agreements because Insurance Company failed to establish the underlying software was exempt or that the agreements did not call for the provision of updates, patches, or "fixes."

ISSUES

I. Gross Retail and Use Tax - Prewritten Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-3-2(e); IC §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1(d)(1); IC § 6-2.5-13-1(d)(2); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-3-14\(2\)](#); [45 IAC 2.2-3-16](#) (repealed); [45 IAC 2.2-5-3\(b\)](#); [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-9\(a\)](#); [45 IAC 2.2-5-10\(a\)](#); Sales Tax Information Bulletin 8 (December 2016); Sales Tax Information Bulletin 8 (November 2011).

Taxpayer argues that the Department erred in denying it an apportioned refund of tax paid on the purchase of computer software claiming that the software was accessed and used by many of its employees located outside Indiana and - in some instances - housed on computer servers located outside the state.

II. Gross Retail and Use Tax - Software Maintenance Agreements.

Authority: IC § 6-2.5-1-14.5; IC § 6-2.5-4-17; *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, (Ind. Ct. App. 1974).

Taxpayer maintains that it is entitled to a refund of use tax paid on the purchase of software maintenance agreements on the ground that the software is itself exempt.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which provides various insurance services including individual policies, retirement plans, and group policies. Taxpayer submitted a refund request seeking the return of approximately \$20,000 of use tax paid on the purchase of computer software and associated maintenance agreements.

The Indiana Department of Revenue ("Department") reviewed Taxpayer's claim granting the refund in part and denying it in part.

Taxpayer disagreed with that portion of the Department's decision denying the refund and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Final Order Denying Refund results.

I. Gross Retail and Use Tax - Prewritten Computer Software.

DISCUSSION

Taxpayer requested a refund of Indiana sales tax paid on computer software it purchased and used to conduct its business. After an initial review, Taxpayer's refund claim was denied in part because "no documentation received . . . proving" the items at issue were nontaxable.

The issue is whether Taxpayer has established that it was entitled to a refund of sales or use tax paid on the purchase of prewritten computer software on the ground that the software was hosted by vendors on computer servers located outside Indiana.

A. Taxpayer's Burden in Claiming a Refund.

When a taxpayer challenges taxability in a specific instance, the taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

B. Indiana's Gross Retail Tax.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). "When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC § 6-2.5-13-1(d)(1). "When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser . . . occurs" IC § 6-2.5-13-1(d)(2).

C. Indiana's Complementary Use Tax.

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is generally functionally equivalent to the sales tax. See *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). However, Indiana's use tax - not sales tax - allows an exception for the "temporary storage" of tangible personal property delivered into Indiana but destined for use outside the state. IC § 6-2.5-3-2(e).

D. Computer Software and Indiana's Sales/Use Tax.

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/use tax:

"Tangible personal property" means personal property that:

- (1) can be seen, weighed, measured, felt, or touched; or
- (2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software.

E. Sales and Use Tax Exemptions.

As a general rule, all purchases of tangible personal property - including computer software - are subject to sales or use tax unless specifically exempted by statutes or regulations. [45 IAC 2.2-5-3\(b\)](#); [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-9\(a\)](#); [45 IAC 2.2-5-10\(a\)](#). Various sales tax exemptions are outlined in IC §§ 6-2.5-5 et seq. which are also applicable to use tax. [45 IAC 2.2-3-14\(2\)](#).

A statute which provides any tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

F. Taxpayer's Software Purchases.

Taxpayer purchased prewritten computer software from various vendors such as Allen Systems Group, Social Security Solutions, Inc., Retail Technology, and Clarizen, Inc. Taxpayer maintains that it did not purchase tangible "software" from these vendors but that it was purchasing computer software based exempt "services" entitling it to a refund of sales or use tax paid on these service-based purchases.

Taxpayer maintains that "prewritten computer software maintained on computer servers outside of Indiana is subject to tax when accessed electronically via the Internet." As authority for its position, Taxpayer cites to the Department's Sales Tax Information Bulletin 8 (December 2016), 20170125 Ind. Reg. 045170026NRA.

Charges for accessing software maintained on a vendor or third party's server is not subject to tax when accessed electronically through the Internet if the customer is not transferred the software, does not have an ownership interest in the software, and does not control or possess the software of the server. Sales Tax Information Bulletin 8 (December 2016).

According to Taxpayer, this Bulletin supports its position that "[p]rewritten software maintained on computers outside of Indiana that are not accessed electronically in Indiana . . . are not subject to Indiana tax." In the case of the transactions which took place prior to July 1, 2018 and regardless of ownership interest, sourcing rules, or delivery location the Department's guidance on this issue is found at Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, which was in effect at the time of the pre-December 2016 transactions and is dispositive of software issues raised here by Taxpayer.

Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet (i.e., "cloud computing"). The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software. Sales Tax Information Bulletin 8 (November 2011).

The Sales Tax Information Bulletin 8 (July 1, 2018) is clear on the application of the 2011 and 2016 Bulletins:

[T]ransactions involving remotely accessed software occurring prior to July 1, 2018, will need to be analyzed using guidance published in the prior version of this bulletin.

In support of its argument, Taxpayer provided copies of vendor invoices along with Internet print-outs describing its vendors' computer software and the services provided by the software. On reviewing the invoices and Internet pages, the Department must conclude that the documentation is insufficient to conclusively support Taxpayer's argument because: (1) the invoices stated zero (\$0) tax was collected on any transaction; and (2) there is little information which is specific to any particular transaction.

For example, Taxpayer paid approximately \$92,790 to Clarizen for software which Taxpayer labels as "Enterprise full software licenses." There is little on the February 2016 invoice other than the notation that it represents "1 payment out of 1 payments for total contract value of \$92,790.00." Elsewhere, Taxpayer explains that the Clarizen software is utilized by its employees located outside Indiana and inside Indiana. As Taxpayer states, "Please be advised that 82[percent] of licensed users of the [Clarizen] software are located outside Indiana." Presumably 18 percent of the users are located within this state.

The Department finds no support for Taxpayer's argument that the taxability of software is apportionable based on the ratio of in-state and out-of-state users. Taxpayer's purchases of computer software entered into before July 1, 2018, are subject to this state's sales and use tax. Taxpayer has not established that its transactions fall into any exemption.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail and Use Tax - Software Maintenance Agreements.

DISCUSSION

Taxpayer seeks a refund of use tax paid on the purchase of software maintenance agreements. Taxpayer explains that the subject software is "remotely accessed, prewritten software not subject to tax" thereby rendering the agreements exempt. For example, Taxpayer states that 18 percent of the Clarizen software users are located in Indiana while less than 1 percent of its Redtail Technology software users are located in Indiana. Taxpayer concludes that "[s]oftware maintenance agreements for remotely accessed, prewritten software are not subject to tax" based on the ratio of its in-state and out-of-state employee/users.

IC § 6-2.5-1-14.5 defines "Computer software maintenance contract" as "a contract that obligates a person to provide a customer with future updates or upgrades of computer software."

Indiana law, IC § 6-2.5-4-17, provides:

A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software. (*Effective July 1, 2010*).

Taxpayer's argument fails because the Department does not agree that Taxpayer has established that the underlying computer software is exempt. The Department does not agree that the taxability of maintenance agreements is apportionable based on the apportioned taxability of the software itself. In addition, Taxpayer has not established that the maintenance agreements fall within the exemption provided in instances in which the agreement does not call for updates, patches, or "fixes."

The Department is mindful of the rule that "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974). The Department is unable to agree that a taxpayer's bare assertion as to the taxability of its maintenance agreements when there is no documentation and no clear legal argument to buttress that assertion.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest of both Issue I and II is denied.

December 31, 2019

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